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# Financial Statements

## A Comparison of Annual Bank Reports

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Two annual bank reports presented to me happened to be complete opposites in appearance and content. The annual report of the Banca Commerciale Italiana was a complete departure from that issued by the Sanwa Bank of Japan. How did they compare with reports issued by United States banks? For a comparative study approximately twenty-five annual reports issued by U. S. banks were selected at random. As a group, these were similar and uniform in content and format and, therefore, are considered as one for purposes of this article.

The Italian and Japanese banks are commercial banks offering a full range of customer services and offering them on an international basis. Both have offices located throughout the world. For comparative purposes the United States banks selected were restricted to *commercial* banks rendering services on an *international* scale.

### Background

Some general information is given on these banks to acquaint the reader with the extent of their international banking activities.

The Banca Commerciale Italiana has its head office located in Milan, Italy. During 1972 a new branch was opened in Tokyo and offices were opened in Chicago, São Paulo and Ankara. The bank had many international branches and offices prior to 1972, including one in New York City.

Sanwa is one of the leading international banks representing Japan. New overseas operations are in Chicago, Hong

Kong, London, Brazil, Singapore, Thailand, Hawaii and the New Hebrides Islands.

Two United States banks shall be specifically mentioned. The Bank of Hawaii has eleven branches in the Pacific Islands in addition to many on the five Hawaiian Islands. Tremendous growth and expansion of their banking activities has resulted recently from foreign investment in Hawaii and the tourist industry.

Bankers Trust New York has had a London office established since 1923 and by any measure ranks among the largest banks in the United States. Branches and offices are scattered throughout the world — Paris, London, Tokyo, Madrid, Rome, Sydney, and Mexico City. In 1972 a five-year \$100 million Eurodollar loan was granted to the government of Yugoslavia; \$70 million was loaned to the Korean government; and an eight-year \$21 million loan was made to Brazil's Companhia Metropolitana de São Paulo-Metro for construction of a new subway system.

The above-mentioned banks do international business and have offices scattered around the globe. Their services are comprehensive and the volume of transactions may be expressed in billions and trillions of lira, billions of Japanese yen, or millions of United States dollars.

At this point, the annual reports are discussed on a comparative basis as to appearance and format, content and length of the letter from the chairman of the board, the financial statements, and the auditor's report.

### Appearance and Format

Sanwa's annual report is large and colorful; its glossy cover picturing the onion blossom. One-third of the total content

contains pictures, charts, maps and diagrams. Its appearance immediately generates favorable reaction from the viewer.

Most American bank reports strive for the same favorable impression. Not all reports are colorful, some are black and white.

At the other extreme is the report issued by the Italian bank. It is small, about half the size of most annual reports, thick and housed in a plain brown cover. There are no pictures, no charts, no graphs. The cliché "you cannot tell a book by its cover" was never truer than in this case. Informative and comprehensive, the written report (discussed in detail later) can and does hold the reader's attention.

The content of each report generally included president's message, review of the economy, financial statements, and an auditor's report.

### Letter by President or Chairman of the Board

The message from the president is usually two to three pages in length and gives a condensation of the year in review. A separate section may elaborate on this, but essentially the topics covered include personnel changes, growth and expansion, investments, the business climate and a brief financial review. The United States banks' annual reports devote anywhere from three to approximately twelve pages to a discussion of the above topics. This is not true of the Sanwa Bank's report nor of the Italian bank's report.

The nonfinancial section of the Sanwa annual report is in four parts:

1. Message from the President (three pages),
2. Review of the Japanese Economy (six pages),

3. International Banking (ten pages), and

4. Domestic Banking (six pages).

The president's message briefly discusses the international economy and monetary system, inflation, pollution and social responsibility, new international operations and finances. A review of the Japanese economy includes changes in domestic business conditions, housing construction and personal consumption and investments. As to international banking residents and nonresidents can open accounts in foreign currencies, bonds are floated in foreign currencies and business is promoted with foreign firms. Domestic banking covers complete customer service (ordinary and time deposit accounts, consumer loans, housing loans); an investment, trustee and securities department; and services in the near-banking field: credit cards, leasing, computer service and credit guarantees. Twenty-five pages, or approximately two-thirds of the annual report, are devoted to non-financial information.

By contrast the report submitted by the Board of Directors of the Banca Commerciale Italiana to the "Ordinary and Extraordinary Meeting of Shareholders held in Milan on 19th April 1973" devotes thirty pages out of a thirty-five page report to a lengthy written discussion uninterrupted by pictures, charts or tables. However formidable it first seems, this becomes fascinating reading as the Italian bankers discuss the economic community in which they must conduct business. On page eleven they stress the

"need to restore a monetary system that will avoid a return to economic autarky and isolationism and so facilitate the recovery and growth of international trade. . . ."

"The world scene is increasingly occupied by big multinational companies whose activities accentuate and promote international economic co-operation, but which at the same time, partly due to the fact that they manage funds in a wide range of currencies, impair the control exercised by the national monetary authorities."

This quote comes from page 12:

"As you know, the last months of 1972 were marked by outbursts of trade union agitation and strikes, some of which . . . was reflected in a large backlog of work, which reached a peak at the end of the year, so that we were obliged to carry forward many transactions required by customers in the last two months, which in a normal situation would have been completed before 31st December . . . Thus, it is estimated, we think fairly accurately, that the year-end totals were swollen for the reasons indicated above by some Lire 300 billion in the case of deposits on current account and by Lire 250 billion in the case of lire advances on current account and bills discounted."

Unique within the Italian Board of Director's report is a detailed description and discussion of all balance sheet accounts including percentage changes and analyses of what brought about these changes.

The report continues in great detail on principal bonds issued to the public, markets for foreign securities, lack of business investment in fixed assets, the economic consequences of unutilized plant capacity. Extremely well written, it further elaborates on the international money market, exchange rates and capital movement.

### The Financial Statements

The balance sheets appearing in the annual reports of the Italian, Japanese and United States' banks were fairly uniform. Classifications, with the items generally appearing under each, were as follows:

#### Assets:

- Cash and Due from Banks
- Investment Securities, Treasury Bills, Mortgages Bonds
- Loans and Bills Discounted
- Bank Premises, Equipment and Real Estate
- Customers Acceptance Liabilities and Guarantees
- Accrued Interest
- Foreign Exchanges

#### Liabilities:

- Deposits (demand and time)
- Acceptances and Guarantees
- Liability under letters of credit
- Accrued Expenses
- Dividends Payable
- Unearned Income
- Foreign Exchange
- Reserve for Price Fluctuations
- Reserve for Possible Loan Losses

#### Capital:

- Common Stock or Paid-Up Capital
- Legal Reserves
- Retained Earnings or Other Surplus

The Italian bank's report combined capital and liabilities under the heading of "Liabilities."

Greater variety appeared in the format and terminology of the income statement. Therefore, the outline is given for a United States bank report, the differences noted between it and the Japanese and Italian statements follow.

#### Operating Income:

- Interest and fees on loans
- Interest and dividends on investments
- Fees and Commissions
- Other Operating Income

#### Operating Expenses:

- General and Administrative Expense
- Interest on deposits, borrowings, rediscounts
- Net occupancy expense of banking premises
- Other expenses
- Income Before Taxes
- Applicable Income Taxes
- Net Income

Variations concerning the income statement were:

1. The title "Profit and Loss Account" replaced "Consolidated Statement of Income" as the name of the statement in both the Italian and Japanese annual reports.

2. The Italian report used "Return on investments and funds employed" in place of the classification "Operating Income."

3. Variations on "General and Administrative Expense" were "Salary and Employee Benefits" and "Cost of Staff."

4. Depreciation of buildings and plant often were separated from occupancy cost.

5. The United States bank statements usually showed earnings per share on common stock.

6. The Italian bank's profit and loss account was a single-step statement listing expenditures first, followed by return on investments.

A few more similarities and dissimilarities concerning the financial statements in general were:

1. Comparative statements were given for at least two years, the current year and the prior year.

2. An analysis of the change in the liability account "Reserve for Loan Losses" was given in one of three ways: by footnote, by supporting schedule, or within the president's or board chairman's report (Banca Commerciale).

3. A Statement of Changes in Capital accompanied most of the financial statements.

4. A Statement of Changes in Financial Position appears only in the annual reports of the United States<sup>1</sup> banks.

### The Auditor's Report

Annual reports of the United States banks contained the standard shortform, unqualified report. At the other extreme, the Sanwa bank's annual report contained *no* auditor's report. The Banca Commerciale Italiana report contained a Report of the Board of Auditors, which may be an external body comparable to an indepen-

Continued on page 28

of the minimum exposure period. The Statement is effective for periods ending after November 30, 1973. It provides that the following information is to be disclosed:

- A statement of translation policies including identification of (a) the balance sheet accounts that are translated at the current rate and those translated at the historical rate, (b) the rate used to translate accounts in the statement of earnings (for example historical rates for specified accounts and a weighted average rate for all other accounts), (c) the time of recognition of gain or loss on forward exchange contracts, and (d) the method of accounting for exchange adjustments (and, if any portion of the exchange adjustment is deferred, the method of disposition of the deferred amount in future years).

- The aggregate amount of exchange adjustments originating in the period, the amount thereof included in the determination of income and the amount thereof deferred.

- The aggregate amount of exchange adjustments included in the determination of income for the period, regardless of when the adjustments originated.

- The aggregate amount of deferred exchange adjustments, regardless of when the adjustments originated, included in the balance sheet and how this amount is classified.

- The amount by which total long-term receivables and total long-term payables translated at historical rates would each increase or decrease at the balance sheet date if translated at current rates.

- The amount of gain or loss which has not been recognized on unperformed forward exchange contracts at the balance sheet date.

Illustrative notes containing the required disclosures are included in an appendix to the Statement.

In addition to Statement No. 1, the FASB has released the Discussion Memorandum relating to Accounting for Research and Development and Similar Costs (public hearing set for March 15, 1974) and the Discussion Memorandum relating to Reporting the Effects of General Price-Level Changes in Financial Statements (public hearing set for April 23, 1974). As explained above, the discussion memorandum merely sets forth the issues and related arguments and implications and does not state any conclusions.

While the FASB has not as yet issued any interpretations of existing pronouncements of the Accounting Principles Board and the Committee on Accounting Procedure, it has the authority

to do so. The procedure is much simpler than that required to issue a Statement. The proposed interpretation must be submitted for comment to the members of the Financial Accounting Standards Advisory Council (the separate advisory group established under the Financial Accounting Foundation) for a period of not less than fifteen days. The FASB may expose a proposed interpretation for public comment at its discretion. An affirmative vote by at least five of the seven members of the FASB is required for issuance of an interpretation.

From this brief review of the accomplishments of the FASB it is obvious that the prodigious pronouncements which were expected by the accounting profession, the financial community and others concerned with the reliability of financial statements have not materialized. The auditors' assurance that a company's financial position and results of operations are presented in accordance with generally accepted accounting principles is still being questioned. The financial analysts and the astute investor study the financial statements and related notes to determine which generally accepted accounting principles are being applied. Earnings of companies who consistently adopt the most liberal accounting methods and who present inadequate disclosures concerning the principles followed are often considered suspect. Subsequent events sometimes prove that these suspicions were well founded. It should not be forgotten that if the FASB falters, the Securities and Exchange Commission and other governmental agencies stand ready to do what the accounting profession cannot do for itself.

While the FASB's decision to add business combinations to its agenda was a result of responses to its own request for comments on prior pronouncements, the SEC's issuance of Accounting Series Release No. 146, *Effect of Treasury Stock Transactions on Accounting for Business Combinations*, must have influenced the decision to some degree. The SEC's influence seems more obvious in the decision to add price-level accounting to the FASB agenda which followed so closely the SEC's issuance of ASR No. 151, *Disclosure of Inventory Profits Reflected in Income in Periods of Rising Prices*. The Commissioners and the Chief Accountant of the SEC have expressed their desire to support and work with the FASB. The Chief Accountant, John C. Burton, has characterized the relationship of the SEC and the FASB as one of mutual nonsurprise where each must advise the other of how they are thinking and what they are doing. On

December 20, 1973, the SEC issued ASR No. 150, *Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards*. This release states:

"... the Commission intends to continue its policy of looking to the private sector for leadership in establishing and improving accounting principles and standards through the FASB with the expectation that the body's conclusions will promote the interests of investors."

However, the release also states:

"The Commission will continue to identify areas where investor information needs exist and will determine the appropriate methods of disclosure to meet these needs."

While the SEC's confidence in the FASB and its desire to work with the FASB is now well known, the SEC's impatience with the FASB is also well known. In a recent speech, Commissioner Sommer pointed out that the FASB must first adopt a policy of deliberate speed. The FASB's handling of the price-level accounting project does seem to indicate an attempt at speedy action.

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## Financial Statements

Continued from page 20

dent accounting firm in the United States. An external board would represent the government and a bargaining process would ensue over the amount of profits on which taxes are to be paid. An internal board would be part of the bank's staff.

## Summary

The major differences may be summarized as follows: The letter to the stockholders submitted by the president or chairman of the board was two to three times longer in the Italian and Japanese bank reports as compared to the length of the same letter in the United States bank reports, as they discussed in much greater depth the national and international financial and economic conditions. The income statements varied in format and contained differing account titles. Only reports issued by United States banks contained a Statement of Changes in Financial Position. These same reports illustrated more financial information by use of charts and graphs. And, the auditor's report ranged from "no report" to the standard unqualified report.